DOW THEORY LETTERS INC.

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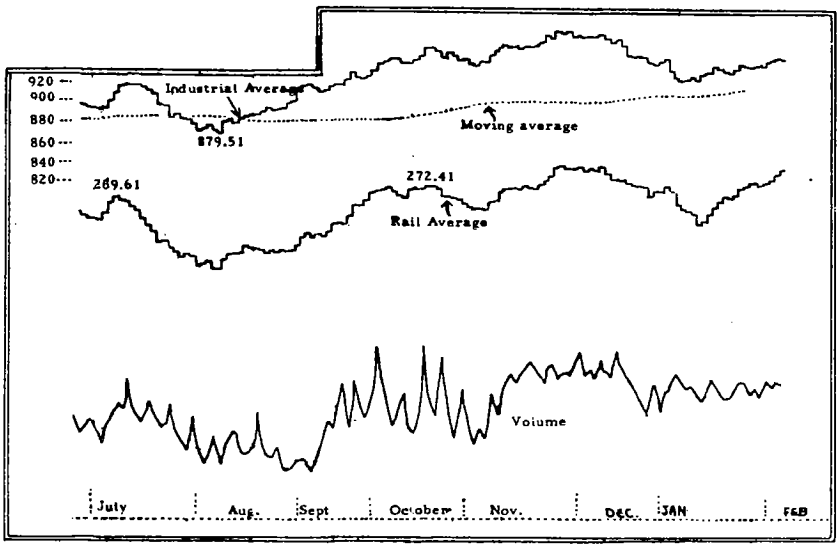
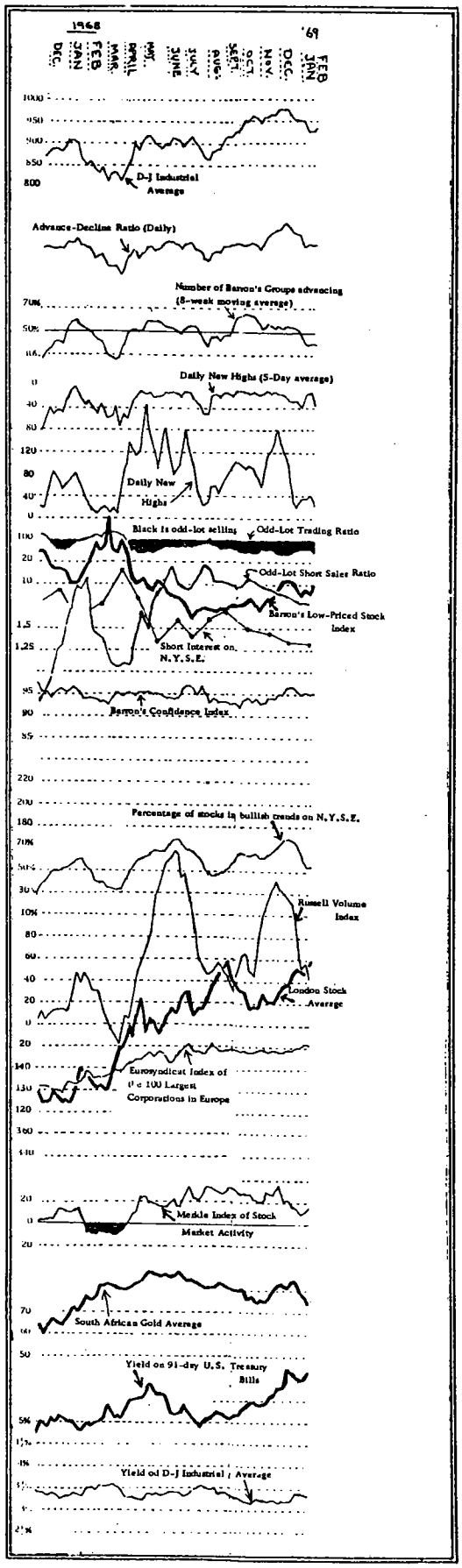
THE MARKET: For five weeks the Averages have been recovering from the sharp and "unexpected" drop of last December. As the recovery continues, nerves are being calmed and bearish fears are slowly being put to rest.

The word from the Washington prophets is that inflation will be slowed, but that everything will be gentle and orderly. Already there are a few scattered signs of economic slowdown. Chrysler has ordered production cutbacks and total U. S. retail sales are slightly sluggish. The crux of it, however, is the public's abiding faith in "fine tuning" by the Government. As the Christian Science Monitor put it last week, "One high Fed official indicated that the central bank would reverse gears if such (slowdown) signs become much more prominent. But as of now, inflation and inflation psychology are still strong. The brakes are still on."

I wish I could believe in the fine-tuning and sure-respond theories of the Administration. But no man or group of men can consistently manipulate the market or the Averages, and therein lies the rub. After all, if the Dow responded like a financial robot, why wouldn't the Industrial Average be far above its 1966 high of 995.15 by now? It has never been that easy!

Conversely, I believe that the Dow during 1969 is apt to be just as "unresponsive" to manipulation on the downside as it has been unresponsive on the upside since 1966. I believe that we are very near the end of the upward part of the second phase of this primary bear market— and that the next phase will be down. When that happens, I believe the Dow Averages are going to make up for the last three years of manipulation with a vengeance. They are going to go down, without regard to the wishes of Wall Street and the politicians, and the




1968
'69
D-J Industrial Average
Advance-Decline Ratio (Daily)
Number of Barron's Groups advancing (8-week moving average)
Daily New Highs (5-Day average)
Daily New Highs
Black is odd-lot selling
Odd-Lot Trading Ratio
Odd-Lot Short Sales Ratio
Barron's Low-Priced Stock Index
Short Interest on N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on N.Y.S.E.
Russell Volume Index
London Stock Average
Eurosyndicat Index of the 100 Largest Corporations in Europe
Meckle Index of Stock Market Activity
South African Gold Average
Yield on 91-day U.S. Treasury Bills
Yield on D-J Industrial Average

 decline is going to throw an unexpected scare into the nation and the world. Everything is alright as long as our politicians and agencies "have control" of events. But when the true primary bear forces come out of hiding, that control is going to go. And that is what is going to change the conplexion of everything.

There is no question in my mind but that the remarkable public complacency since 1958 has been brought about by the public's increasing confidence in the infinite wisdom of Washington. But bear markets, by their nature, smash confidence and raise questions which cannot be answered by controls, manipulations, charts and graphs. Disillusionment is the handmaiden of a primary bear market, and we are heading steadily towards the period of great disillusionment.

I have been writing continually of the coming confrontation between the forces of inflation and deflation. With the entrance of the year 1969, the confrontation is on. I believe that Mr. Nixon and his advisors are sincere men; they mean to slow or stop inflation. But I also feel that these men are unaware of the great primary bear forces which have been lying dormant for the past three years, lying dormant yet gathering strength with which to express themselves.

For months the experts have been promising us that the worst has been seen on the interest rate front. Meanwhile, the market has been saying it isn't so. For instance, on February 3 the bellwether of the U.S. Government bond market, the 4¼'s of 1987-92, plunged to a new record low of 75 11/16 bid, at which level they yield an incredible 6.19%. Since bond yields are ultimately competitive with stock yields, this is a major deflationary force at work. Not only are bond yields competitive with stock yields, they are competitive with all other yields including mortgage yields, business yields, savings bank yields.

To put the matter into "living perspective," I include this paragraph from the February 1 Business Week: "A seller can relax, but a house-buyer is in a bind. This year you're faced with a price and mortgage squeeze that's at a crisis stage. Mortgages: Last week the ceiling on FHA backed loans was raised to 7.5%. This week the government reported that the average conventional mortgage rate for December was 7.23%. In many affluent suburban towns, rates go to 8%—with discount 'points' adding to a buyer's burden."

All this, of course, Wall Street knows, and all this it is and will be discounting in the period ahead. A glance at the page one chart will suffice to show that the Industrials and Rail Average are now getting "out of gear," often a signal of forthcoming danger. As this is written, Industrials have failed to make up even half of their December losses while the Rail Average is flirting with its all-time high of 279.98 established in early December.

There have been many individual days of divergence (one Average rising while the other declines) and this too is a sign of danger. I would say that the longer this out-of-gear and divergent action continues, the more the odds favor trouble ahead.

The advance-decline ratio has flattened out, seeming to be particularly unresponsive to any upside action in the Averages. Last week the Russell Volume Index (see long page 1 chart) provided a downward zig-zag while dropping to its lowest level in five months.

* * * *

As this is written, there seems a good chance that Rails will hurdle their 1968 all-time high of 279.48. If so, the market will be in the position of witnessing the third major non-confirmation between Industrials and Rails since 1966. Of course, the non-confirmatory structure could be erased if Industrials then push to an all-time high above the 1966 peak of 995.15. But a Rail high above 279.48, unconfirmed by a new Industrial high, would simply add another dangerous element to the price structure.

THREE YEARS: February 9.....on February 9 it will have been three years since the D-J Industrial Average posted its record bull market high of 995.15. It is incredible that now, three years later, the Dow is still within 50 or so points of that high.

The only bull market in history comparable to the 1949-1966 bull market was the primary bull market of 1921-1929. Three years after the 1929 top the Dow had totally collapsed, having erased 89% of its 1929 peak value (a drop from 381 to 41). The situation since 1966 could not have been more different.

Nevertheless, I see little cause for rejoicing in the difference, at least on a long-term basis. For the question on my mind is, what was done since the February 9, 1966 peak to hold back the primary bear forces? The list of manipulations has been a long and astounding one, and they have been covered in detail here many times before. That list includes squandering the gold base of the dollar, squandering the silver base in our coinage, depleting the nation's

resources in a long and fantastically costly war, pumping the U.S. money supply to heights wich fostered galloping inflation and loss of confidence in our currency, and perhaps worst of all— spoon-feeding the American people on a raft of half-truths, wishes, fiscal machinations and political hand-outs.

In a more-than-fair appraisal of our new President Nixon and his capabilities, economist-publisher Eliot Janeway presents the current picture as he sees it: "Some Presidents take office under circumstances that warrant bullishness when they perform well. But the receivership that has fallen into Nixon's lap has been so mangled by mismanagement that there isn't going to be any inconsistency for months and perhaps years between awarding him a high job rating and running scared on the bearish side of the jungle." In other words, even though Nixon may be doing well, Janeway believes that there is enough wrong following Johnson's reign, to keep us on the edge of our seats and sweating.

The picture I have been attempting to paint is one of a primary bear market which has been subject to every form of manipulation which a political Administration can get away with. The result has been to hold the D-J Industrials within 50 points of its bull market high— three years after the top.

Yet as Robert Rhea, the great Dow Theorist of the 1930's so often pointed out, no amount of Governmental manipulation can keep the market from ultimately expressing itself in the direction of the primary trend. Past history, in fact, indicates that the longer the primary forces are held back or manipulated, the greater the eventual expression of those forces.

The most stunning examples of that thesis within recent memory were the aftermaths of the bull market correction of 1957 and 1962. Both of those reactions were counter to the prevailing primary bull trend, and following both of those reactions (with a short interest on the N.Y.S.E. far below that which exists today) the Averages marched relentlessly to new highs. Nothing of the sort has occurred since the initial downward leg of this primary bear market (which occurred in 1966). As I pointed out in Letter 416, the Averages since 1966 have traced out a series of three major non-confirmations. Following the 995.15 Industrial peak and the 271.72 Rail peak of 1966, Rails pushed up to new record highs in 1967 of 274.49. Again in 1968 Rails rose to a further record high of 279.48. Neither Rail high was confirmed by Industrials.

Where does this leave us? As far as I am concerned, it leaves us in the dangerous position (see chart page 4) of watching and waiting while the greatest bear market (upward) reaction in history slowly burns itself out. One sign of the burning out process is the "temperature" of the money market. The money market is running a fever of 106, and I include one particular fever chart, the yield on Municipal Bonds. Last week average yields on Municipals (which are free from Federal income taxes) rose to 4.90%, highest since January, 1935. Furthermore, over the past six months the average Municipal Bond has dropped 10% in value, thereby wiping out millions in investment protfolio values.

Now consider Nixon's dilemma. Bonds have been collapsing in the face of a massive inflation of the money supply. What happens if Mr. Nixon, in order to slow inflation, insists on a contraction of the money supply? What happens is likely to be chaos in the money market, at least more chaos than exists at present. If you were

Mr. Nixon what would you do to slow inflation, yet not upset the apple cart?

To use a simile, if an apple cart is knocked over on the street, most of the apples can be saved (give or take a few bruises). But when an apple cart is pushed off a ten story roof, the damage to the apples is terrific. The American apple cart is now perched way up on the roof. The money supply is blown up, demand deposit turnover is huge, interest rates are the highest in 100 years, production and spending are at record levels. All this has to slow down if inflation is to be slowed and if the dollar is to be saved. And time is running out.

FUND SALES: Sometimes a chart can say what no amount of description can. I present this chart of mutual fund sales to show subscribers the fantastic picture of sky-rocketing public money going into the market. While it is true that the odd-lot figures present a picture of a public which is selling more than they are buying, one wonders if the public is not selling individual odd-lots and to a large extent plowing this money into the mutual funds.

I might add that this chart picture is not at variance with what I would expect during a great upward movement within a continuing primary bear market. For if mutual fund sales represent a method of selling stock to the public, then Wall Street is in the process of massive distribution of equities to the public. It's hard to argue with the charts, and that is what the chart suggests.

THE BRAKES ARE ON: The new Administration puts inflation as the number one domestic problem. Of course, the old Administration had been mouthing pious words about inflation for years, but as it all turned out, Johnson's anti-inflation policy was all a figment of hopes, wishes and ineffectual ploys.

I have the feeling that the American people do not take Mr. Nixon seriously regarding anti-inflation. After all, 1968 saw the biggest rise in consumers' prices in 17 years, so why should everything suddenly slow down now? People are not going to take a slowdown in inflation (or deflation) seriously until they see it with their own eyes. Until then.....the trend continues.

Odd-Lot Purchases Of Treasurys Climb, New York Banks Say

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Government Issues' High Yields Appear to Lure Savings Away From the Thrift Institutions

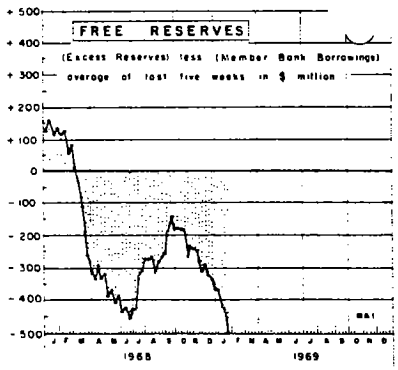
By a WALL STREET JOURNAL *Staff Reporter*

NEW YORK—New York City banks are reporting sharp increases in odd-lot purchases of Government bonds. They regard this as another sign that high interest rates in the money market are drawing some individual savings away from the nation's thrift institutions.

Normally, very few individuals put their savings into Government securities. Though limits vary from dealer to dealer, a transaction of less than $50,000 to $100,000 would be considered an odd lot in the bond market.

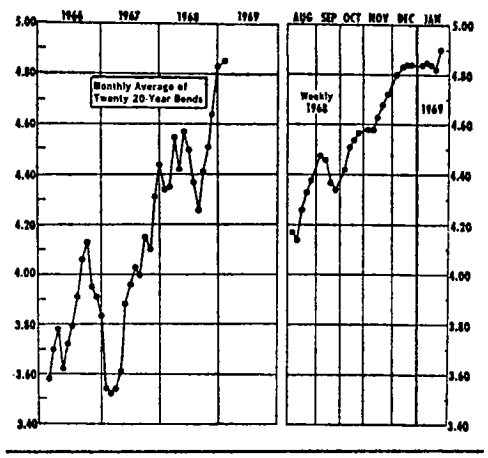
Morgan Guaranty Trust Co., New York City's fourth largest bank, said it had experienced "an alarming increase" in odd-lot transactions, most markedly in the last month. According to a bond department official, the number of trades stepped up, while their average size dropped. Where once 700 to 750 transactions were required to do a given dollar volume of business, the number had recently jumped to 1,100 to 1,300 transactions, he said.

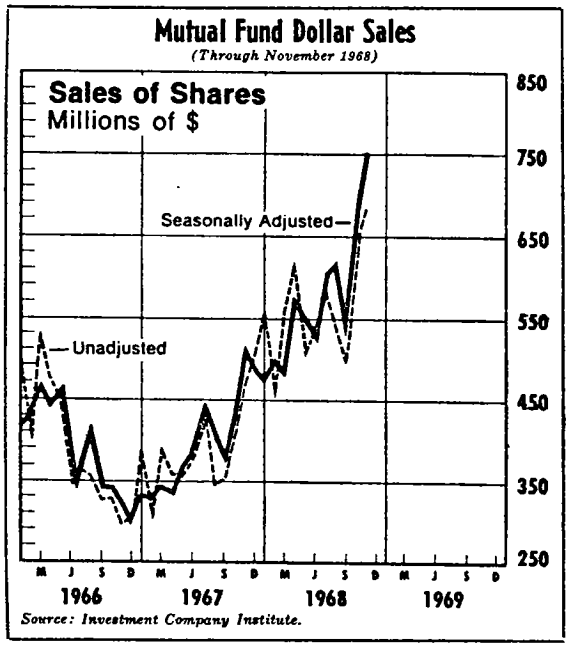
Other banking sources noted like increases. Odd-lot transactions at First National City Bank climbed about 30% since mid-December, a bond trader estimated. He noted, however, declines in odd-lot purchases last week.



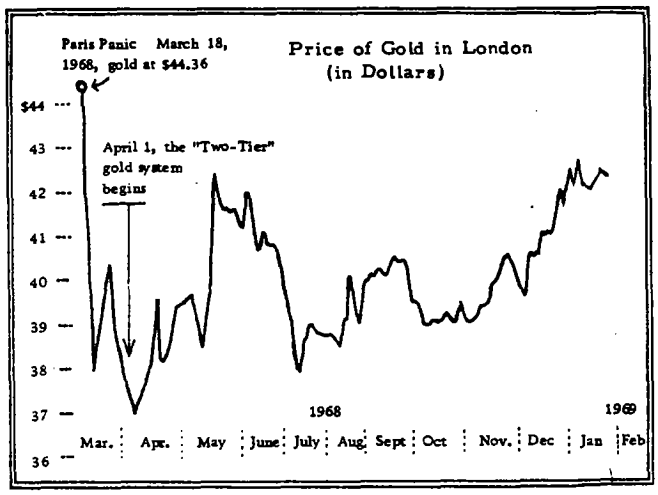
But the Federal Reserve Board may be taking Nixon seriously since last week (see chart, which is only a five-week moving average) the member banks' reserves went into the biggest squeeze in sixteen years (minus or net borrowed reserves rose to $758 million).

Last week U.S. Treasury refinancing showed evidence of the extraordinary money conditions. The Treasury offered a 15-month and a seven year note. Selling on a when-issued basis, the 15-month note went to a yield of 6.42%, highest return on any Treasury issue since 1865. The seven-year note sold at a 6.29% yield. As a point of interest,





it should be remembered that at 6% interest, money doubles every 12 years.



The record Treasury debt yields are now beginning to attract the public, as this article from the Wall Street Journal attests. With the banks and the savings & loans paying in the neighborhood of 5% interest, 6% and more from the U.S.Government is becoming irresistably attractive. Movement out of savings institutions towards U.S. Government debt will and is creating problems. Those problems should show up shortly in the mortgage market. The insurance companies, big mortgage lenders, will in particular find it hard to justify purchase of mortgages in the face of the juiciest bond yields in a century. All of this will be reflected as 1969 moves on.

GOLD: On January 15 (see chart) Secretary of the Treasury Kennedy's now-famous "pliable!" statement on the price of gold resulted in a rise in the London price of gold to $42.75, a record under the two tier system. A week later, Kennedy took a rather stronger stand on $35 gold, and the price in London dropped to $42.05. Since then, gold has been climbing in London and by late last week the price was flirting with the record $42.75 peak again.

As seen on the gold chart, the price of gold is still very much in a steady uptrend, and, in fact, the latest Nixon statement hardly budged the London gold price downward. What could the rising trend in gold mean? It could simply reflect a supply-demand situation in the yellow metal or it could indicate the gold buyers are more and more certain that something is going to happen (or something is going to give) on the gold front.

I continue to believe that a hike in the price of gold could be part of some secret deal with Russia in return for peace in Vietnam and perhaps peace in the Middle-East (with French cooperation). It should be remembered that most of the nations of Europe also favor a gold price hike, and that the pressure is steadily and silently mounting in favor of the great price boost.

On top of this, Mr. Nixon (I feel) tends to be a realist, and there is no denying the persistent gold price level now above $42 per ounce in London. At $42, the U.S. dollar is selling at a discount of better than 20% in terms of gold. That is the actual world market price for dollars, not the U.S.—sponsored fixed price. Nixon knows this, and he also knows that ultimately in a battle between the forces of the free market and the forces of manipulation, the free market wins. To put it another way, the longer the battle between the manipulators and the free markets, the more costly the price to the manipulators.

Therefore, I feel that President Nixon is very likely to bow to reality and revalue gold. It would also pay him to take the step prior to a crisis, while he still has reasonable control of circumstances. If our Administration elects to wait for a crisis (perhaps a rise in the gold price to over $50 in the free market) then their options (a favorite Nixon word) will be greatly reduced.

My conclusion, then, is that President Nixon must move fast on two general (and I believe connected) fronts. The first is the gold front. He should make a decision here, and fairly fast. If Nixon does not decide on gold, Gold may decide about Nixon and the U.S. The second front is Vietnam. It may be necessary to move on gold before Russia and the Communists will move on Vietnam. If peace does not come within six months in Vietnam, Nixon will inherit "Johnson's war." Therefore, whether he likes it or not, the pressure is on Nixon to move. The Communists know this. The result must be compromise, with each side giving in on important issues. This is what I expect will happen during the next six months.

As an important aside, I was particularly interested in a paragraph in the latest International Harry Schultz Letter regarding Secretary Kennedy's strange gold statement. Here's how my friend Harry put it: "Secretary Kennedy's gold statement was widely expected. It was most moderate. What he said, in fact, went without saying—so nothing has

changed. He said simply that the U.S. would not seek an answer to problems via a gold price change. Nor should he. Not on his first day in office anyway. His phrasing was politically astute, one rarely does look to gold first. Government is expected to look elsewhere first, and then, if nothing can be done elsewhere, they have tried and come back to gold as the answer. He left himself ample room to change the price later. Note he did not repeat the pledge to redeem dollars. He couldn't without encouraging many takers. While many of us would have been happier if nothing had been said, one must be realistic and admit that in his position something had to be done to prevent a run on the dollar. And what Kennedy said was acceptable to both the pro and anti gold factions."

MARKET LABORATORY: I have just thumbed through the entire book of daily charts published weekly by Traders Research, 101 Cherry St., Alton, Ill. 62002. What I see here is a great many toppy formations in individual stocks. Many stocks have broken down, others are forming various top formations such as the three "head-and-shoulders" tops which I have shown on this page (charts from Traders Research).

I have shown these three charts because they are both typical of numerous formations which have now formed, and because they are all perfect head-and-shoulders tops. In my experience, once this many tops occur in individual stocks, it is a sign of important distribution. On occasion, a violent upward thrust of the general market will take head-and-shoulders patterns (such as those shown here) to new highs, but the mere appearance of these tops is an ominous sign.

In each case, I have drawn a dotted "neckline" or support area on the charts, and as can be seen, each chart shows a well defined left shoulder (L on chart), a head (H on chart) and a right shoulder (R on chart). Classically, when the price breaks below the neckline (dotted line) the distribution is completed. In all three cases, the right shoulder (R) is poised to break below the neckline, but in no case has the penetration yet occurred.